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C O N F I D E N T I A L SHENYANG 000016

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TAGS: ECON EFIN ETRD ELAB PGOV CH

SUBJECT: CASH FINANCING MAINTAINS HOUSING BOOM IN NORTHEAST CHINA

Classified By: Consul General Stephen Wickman reasons 1.4 (b and d).

**¶1. (U)** Summary. Similar to the early days of the boom in other parts of China, housing developers in Northeast China raise cash chiefly through high-return, advance purchase agreements without recourse to the banking system and are thus immune from tighter credit controls. The current glut of cash, moreover, coupled with recent instability in equity markets, seems to be driving this type of investment to even higher levels, with no real end in sight. In this relatively land rich area, housing developments are quickly consuming what was previously agricultural land, and sometimes in direct violation of local regulations. Prices continue to rise, especially in Dalian and Shenyang, while trends in the U.S. market are prompting growing numbers of U.S.-resident Chinese to invest here as well. End Summary.

Advanced Sales Built on High Expected Rates of Return

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**¶2. (U)** The headlines in Shenyang this week trumpeted the first slowdown in housing price increases (6.1 percent year-on-year) in five years, but developers tell us the market is still hot. Housing developers throughout Northeast China, moreover, say they have little, if any, problem in financing new projects despite efforts to restrict lending elsewhere in the country. Neither rising interest rates nor higher liquidity requirements placed on lending institutions have much impact since most developers do not require bank loans. While some developers may use loans to finance initial start-up costs (e.g., land purchase, permitting, design) most form syndicates to finance even the initial outlays. The planned units are sold well prior to the start of construction, frequently with an agreement that the developer will repurchase the unit on completion at a prearranged price. The initial &sale8 is generally priced at slightly more than half of the current market average, per square meter, making residential real estate largely a cash market with high, built-in expected rates of return. Local experts report that less than forty percent of residential real estate in the region is encumbered by any type of a mortgage.

**¶3. (U)** According to Liu Jun, General Manager of Hongda Development, ninety percent of residential developments self-finance via advanced sales. He said the current turbulence in global finance and equity markets is actually making things easier, noting that as people become more frightened of equity markets, housing becomes a more attractive alternative. For example, Mr. Liu told Econoff, that he did not yet have any drawings for one planned development that is already thirty-percent sold. Mr. Liu explained there was no need for even an artist's conception when selling at what buyers perceived to be &below-market8

prices.

**¶4. (C)** Developers in the Northeast, Mr. Liu went on to say, are politically well-connected and able to negotiate the permit process smoothly, despite recently announced central government restrictions to curb the destruction of farmland and impose even tighter environmental controls. According to Liu, the central government's desire to develop the Northeast trumps such environmental concerns. And where local officials resist, Liu said, an appropriate "gratuity" invariably solve the problem.

Booms in Shenyang, Dalian, Harbin and Beyond

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**¶5. (SBU)** Our contacts report that residential sales in Shenyang's Hunnan zone, just south of the city, remain brisk, and the average price per square meter within the zone has risen to nearly RMB 7000(USD ???), about 75 percent higher than the overall city average. Most projects have completely sold out the units scheduled for completion over the next two years. The sell-back price for the completed units nets nearly a forty percent annualized return on investment to the original purchasers. Foreign investors, especially from South Korea, are very active in the market. Our contacts in Harbin, the capital of Heilongjiang Province, prices are lower, but the overall pattern is the same as in Shenyang, with Russian investors leading the way.

**¶6. (U)** Huaxin Development Company, a Singapore-based developer having major interests in Shenyang, expects booming sales and rentals due to huge jumps in projected employment, especially in Shenyang's southern areas. Foxconn's projected employment of 50,000 people at its new plant, GE's continued expansion, and the coming move of commercial aircraft

production south of the river are fueling market optimism. Huaxin, in a joint venture with Oakwood, plans to construct a new service-apartment development complex in the area, right down the street from a similar home-grown complex, part of a chain that has been mushrooming in second-tier cities all over China. Sujiatun district, also to the south and near the current international school, is seeing robust growth as construction of a new, high-speed road accessing Shenyang's airport and aviation zone, moves rapidly forward. Lufthansa's recent start of direct flights to Shenyang is adding to enthusiasm about areas near the airport.

**¶7. (U)** Roughly four hours south of Shenyang by car, Dalian's longer-running boom has spread up the peninsula to the Dalian Development Zone and Changxing Island, two of former Liaoning Party Secretary and new Politburo Standing Committee Member Li Keqiang's five & points8 for development. Prices in Dalian are the highest overall for Northeast China, with the average price per square meter nearing RMB 10,000. Changxing Island values jumped to an average of RMB 3000, an increase of RMB 1200 over prices just six months ago.

8.(U) Changxing Island, which until one year ago was totally agricultural, is developing especially rapidly. Both wind and nuclear power stations are being installed, and the newly constructed Changxing Harbor has begun operation. South Korea's STS Shipbuilding has its new plant in operation and will float its first vessel from the facility in late 2008. The local government put up the initial money for residential developers in order to provide housing for displaced farmers, but many are opting to sell their new homes and seek opportunity in Dalian proper.

**¶9. (U)** Another interesting trend is a jump in investments by overseas Chinese, especially those from the United States. Since the U.S. market has soured, many U.S.-resident Chinese are opting to move their money into the Northeast China real estate market. One investor, for example, told us that rising real estate prices, coupled with the renminbi's appreciation against the dollar, make China real estate an

ideal target. She went on to say that, because she is still a Chinese citizen, she is not troubled by Chinese currency regulations designed to keep foreign investors from "flipping" houses to make a quick profit. Confiding that it is easier and cheaper to convert dollars to renminbi through the black market than a bank, she claimed to have brought in the purchase price for her investment property (about USD 40,000) in her handbag.

Comment: No Bubble or Protests...Yet.

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¶10. (C) Although the picture in the market for hotel and office space is less clear, residential real estate in Northeast China seems to be a boom market that is impervious to monetary controls and, so far at least, is avoiding a bubble. Investors in the housing market have plenty of cash ) much of it from outside the region - to bid up prices and spur construction. With the region's relatively low population density and rapid job growth, the trend should continue for the near term, possibly fueling corruption and conflict with ousted residents or marginalized farmers. To date, however, the only visible signs of the conflicts are in the form of graffiti scrawled on walls slated for demolition. Most farmers and urban residents appear to be satisfied with their compensation for moving and their new homes, although they grumble about the even higher profits of the developers and officials, whom they assume to be in league and corrupt.

WICKMAN